Glasgow City Council

Strathclyde Pension Fund Committee

Report by Director of Strathclyde Pension Fund

Contact: Jacqueline Gillies, Chief Investment Officer, Ext: 75186

Item 6

23rd November 2022

Investment Update

Purpose of Report:

To provide the Committee with an investment update including a summary of:

- investment performance to 30th September 2022
- portfolios as at 31st October 2022
- the Investment Advisory Panel meeting of 10th November 2022 and
- stewardship activity during Quarter 3 2022.

Recommendations:

The Committee is asked **to NOTE** the contents of this report.

Ward No(s): Citywide: ✓

Local member(s) advised: Yes ☐ No ☐ consulted: Yes ☐ No ☐

PLEASE NOTE THE FOLLOWING:

Any Ordnance Survey mapping included within this Report is provided by Glasgow City Council under licence from the Ordnance Survey in order to fulfil its public function to make available Council-held public domain information. Persons viewing this mapping should contact Ordnance Survey Copyright for advice where they wish to licence Ordnance Survey mapping/map data for their own use. The OS web site can be found at <http://www.ordnancesurvey.co.uk> "

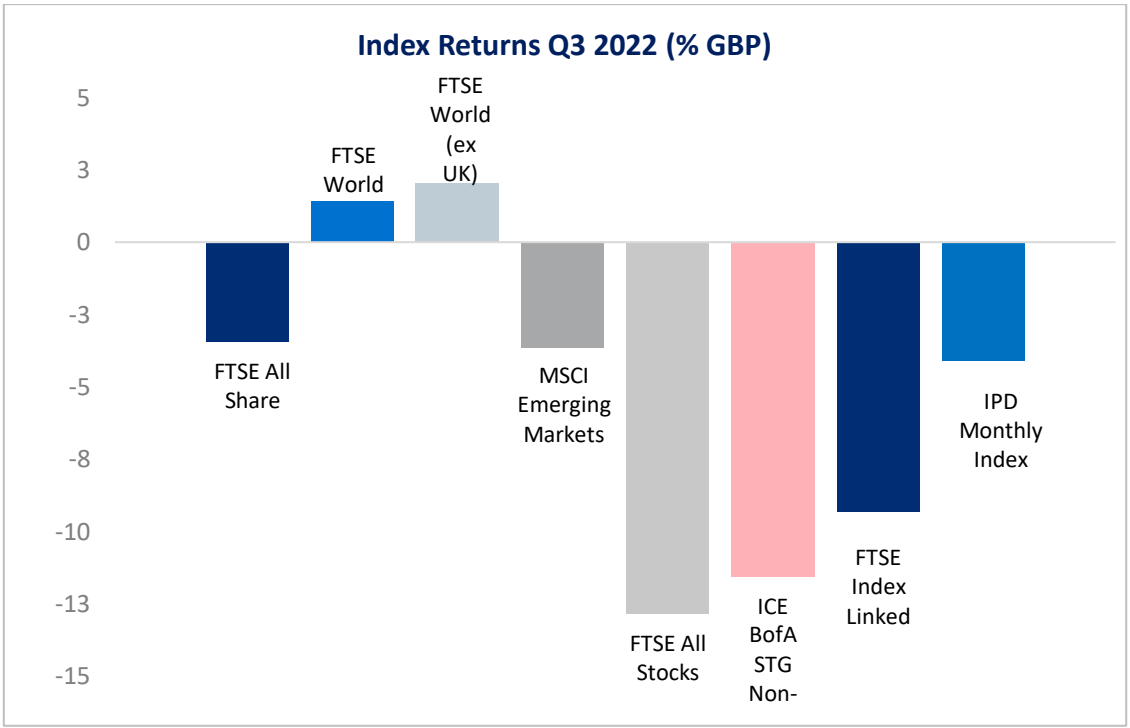
If accessing this Report via the Internet, please note that any mapping is for illustrative purposes only and is not true to any marked scale

1 Investment Market Performance

Global equities fell once more in the third quarter as markets contended with continued inflation, rising interest rates and a worsening economic outlook.

In the UK, inflation reached 10.1% in September, and consumer confidence dropped to an all-time low. Elsewhere in Europe, the squeeze on Russian gas volumes resulted in a spike in gas prices. High gas prices weighed heavily on manufacturing making recession more likely. US equities rose initially but declined in August and September as the Fed went ahead with two interest rate hikes. Japan outperformed over the quarter as weakness in the yen supported exports. Emerging markets underperformed, the key detractor being China.

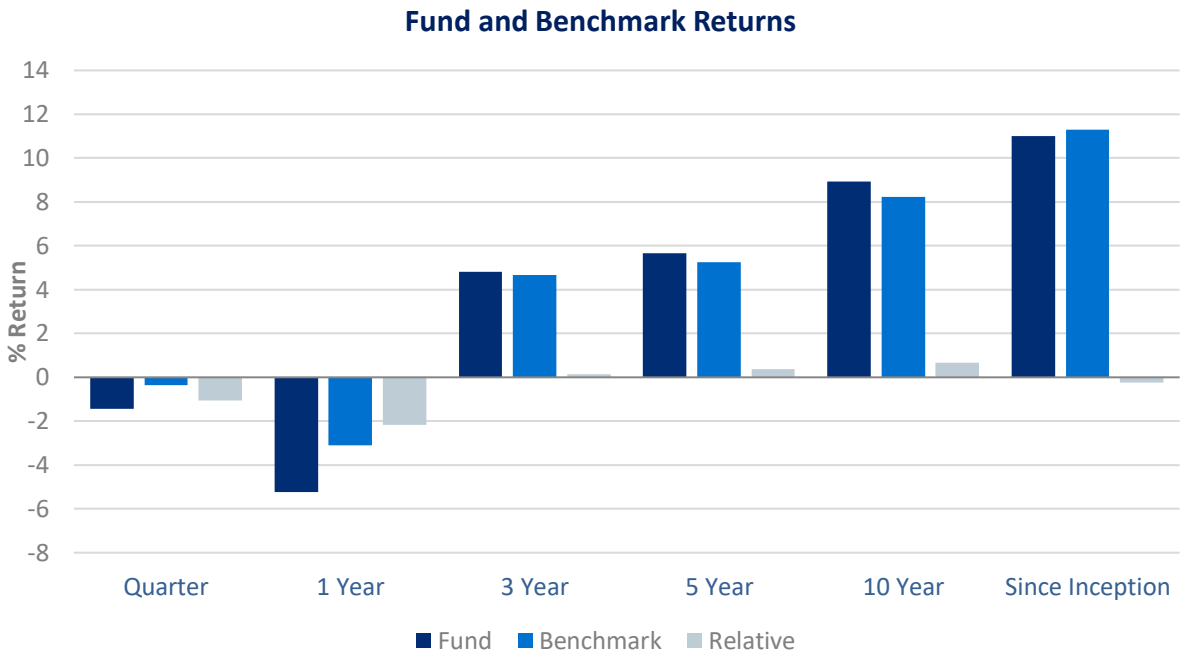
Yields on global government bonds rose substantially in the third quarter as central banks guided towards higher interest rates in a bid to combat inflation.



- The **FTSE All Share** Index returned **-3.4%,** the **FTSE World ex UK** index **+2.3%** and the **MSCI Emerging Markets** index -**3.6%**, compared with Q2 returns of **-5.0%**, **-9.3%** and **-3.9%** respectively.
- The **FTSE All Stock Index** returned **-12.8%**. In September, sterling fell in response to the Government's announcement of energy subsidies and tax cuts, which would increase borrowing. Gilt yields soared, with 10-year yields rising from 2.2% to 4.1% over the quarter and touching 4.5% in the last week of September. The Bank of England intervened and announced plans to purchase £65bn of long dated gilts to contain the damage to the financial system.
- **Sterling** fell by **-1.8%** against the euro and by **-7.8%** against the dollar.
- The **MSCI All property monthly return index** declined by -**4.1%** over the quarter. Capital values declined over all sectors. The main detractor was the industrial sector, which had been a top performer since the pandemic.

2 Total Fund Performance

The **Fund's total return** for Quarter 3 2022 was **-1.4**%, behind the benchmark return of **-0.4%.**



The **Fund's value** at 30th September 2022 was **£26,430m**. (Fund value at 30th June 2022 was **£26,818m**).

3 Performance Analysis

Further performance analysis is set out in **Appendix 1**.

4 Portfolio Summary as at 31st October 2022

As at 31st October, the Fund's value had increased to **£26,747m**.
A summary of investment manager portfolios as at 31st October is set out in **Appendix 2**.

5 Investment Advisory Panel

The Fund's Investment Advisory Panel met on 10th November 2022. A note of the Panel's meeting is set out in **Appendix 3**.

6 Stewardship: Responsible Investment

A summary of responsible investment activity is included **at Appendix 4**.
Highlights include:

- The Fund was confirmed as a 2022 signatory to the **UK Stewardship Code** based on its 2021 annual submission.
- **2021 PRI survey** results were received. The Fund continues to perform in the top tier of global PRI signatories and achieved a maximum overall 5 stars.
- DTZ Investors reported that to further support their commitment to net-zero, they have become a signatory of the **Better Building Partnerships Climate Commitment**. They also reported on the Global Real-Estate Sustainability Benchmark (GRESB). This is the primary industry benchmarking tool for measuring a property portfolio's ESG

performance. Results for SPF's 2021/22 submission were published in October. The Fund obtained a score of 70/100 (30/30 for the Management module and 40/70 for the Performance module) and 2 Green Stars.

7 Policy and Resource Implications

Resource Implications:

Financial:	None
Legal:	None
Personnel:	None
Procurement:	None
Council Strategic Plan:	Strathclyde Pension Fund aligns with the theme of a well governed city.

Equality and Socio Economic Impacts:

Does the proposal support the Council's Equality Outcomes 2017-22	Equalities issues are addressed in the Fund's Responsible Investment strategy, in the scheme rules which are the responsibility of Scottish Government and in the Fund's Communications Policy which has been the subject of an Equalities Impact Assessment.
What are the potential equality impacts as a result of this report?	No specific equalities impacts.

Climate Impacts:

Does the proposal support any Climate Plan actions? Please specify:	N/A. Monitoring report. Strathclyde Pension Fund's Climate Change strategy is being developed in line with Item 34 of the Council's Climate Action Plan.
What are the potential climate impacts as a result of this proposal?	N/A.
Will the proposal contribute to Glasgow's net zero carbon target?	N/A.

Privacy and Data Protection impacts: None.

9 RECOMMENDATIONS

The Committee is asked to **NOTE** the contents of this report.

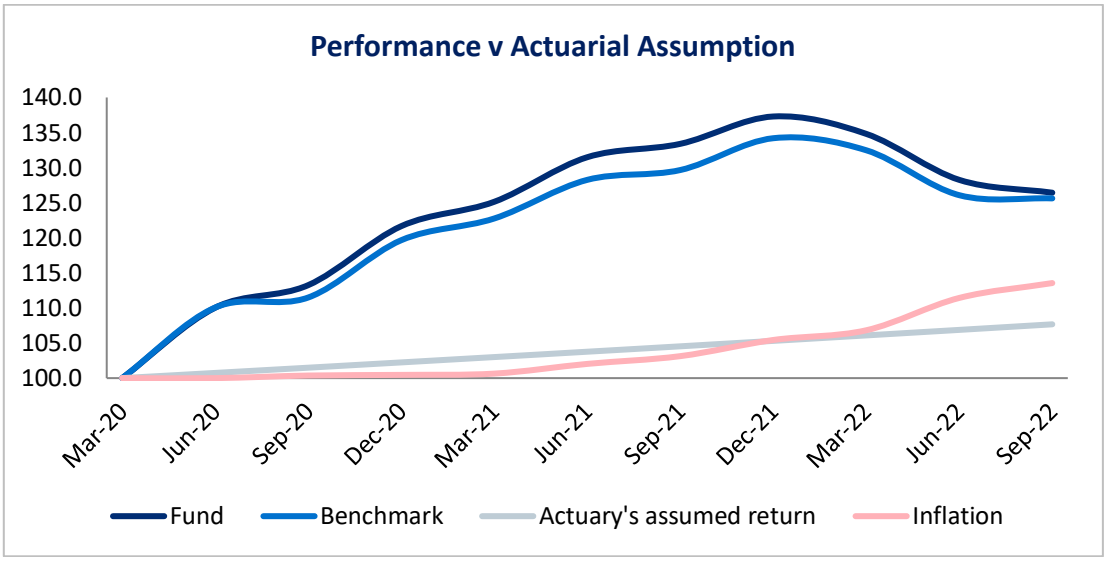
Appendices

Appendix 1 Performance Analysis
Appendix 2 Portfolio Summary as at 31st October 2022
Appendix 3 Note of Investment Advisory Panel meeting on10th November 2022
Appendix 4 Stewardship: Summary of Responsible Investment Activity

Appendix 1

Performance Analysis

1 Investment Performance vs Actuarial Assumption



Despite a downturn in performance since the start of 2022, the Fund has achieved a return significantly greater than the actuarial assumed return of **+3.0%** per annum since the 31st March 2020 valuation. The Fund's cumulative return to date remains comfortably ahead of rapidly rising inflation.

2 Performance by Asset Category

Asset Class	Latest Quarter			1 Year		
	Fund %	Bench mark %	Relative %	Fund %	Bench mark %	Relative %
Equity	(1.0)	(0.8)	(0.2)	(8.9)	(8.2)	(0.8)
Hedging & insurance[1]	(2.7)	(10.6)	8.8	(2.4)	(29.3)	38.0
Credit	(9.5)	(9.5)	0.0	(23.2)	(23.3)	0.1
Short term enhanced yield	(1.2)	0.7	(1.9)	(4.3)	1.3	(5.5)
Long term enhanced yield	(0.5)	3.3	(3.6)	14.0	15.4	(1.2)

[1]This Hedging and Insurance portfolio was invested in passive index-linked gilts >5 years until June 2021. In June 2021, the index-linked portfolio was divested, with the proceeds held in cash funds. In September 2022, the cash portfolio was switched to units in a passive gilts <5 years fund. Benchmark for hedging and insurance remains FTSE Index-Linked Gilts >5 years.

3 Performance by Investment Managers

Each of the Fund's investment managers has an individual portfolio benchmark. In Quarter 3:

- 6 managers outperformed their benchmark; and
- 15 managers underperformed.

Equity returned **-1.0%,** behind the benchmark of **-0.8%**. **Pantheon** was the strongest performer in both absolute and relative terms, while **Oldfield** was the weakest performer.

Lazard and **JP Morgan** outperformed, with **Baillie Gifford** also marginally outperforming after two quarters of significant underperformance. **Veritas**, **Lombard Odier**, **Active Emerging Markets** and **Partners Group** underperformed.

Short term enhanced yield returned **–1.2%**, behind the benchmark of **+0.7%**. The only managers to outperform their benchmarks were **Ruffer** and **Barings** (Private Debt). The most significant detractors were **PIMCO**, **Ashmore**, **Barings** (Multi-Asset Credit) and **Oak Hill**.

Long term enhanced yield returned **-0.5%** over the quarter, underperforming the benchmark of **+3.3%**. All 3 managers (**DTZ, Partners Group Real Estate and JP Morgan IIF**) underperformed their benchmarks. In absolute terms, the strongest performer was **Partners Group**.

4 Direct Investment Portfolio (DIP)

As at the end of September 2022, DIP comprised **57** investment commitments, totalling **£1,918m. Net Asset Value** was **£1,255m** at the end of the quarter.

Portfolio performance to 30th September is as follows.

	Q4 2021 (%)	1 year (%)	3 years (% p.a.)	5 years (% p.a.)	Since Inception (% p.a.)
DIP	2.8	13.4	5.9	6.1	7.7
DIP Benchmark*	3.1	10.6	6.3	4.7	2.4
SPF Total Fund	(1.4)	(5.2)	4.8	5.6	11.0

Source: Northern Trust
* CPI +3% pa from 2019; previously LIBOR

Quarterly performance was positive mainly due to improving performance from the generally larger and more numerous LTEY investments.

Overall, the portfolio has performed well as have a majority of its individual investments. On a RAG analysis:

- **49** investments are rated **green** (no change)
- **4** are **amber** (increase of 1)
- **None red**.
- **4** are in legals

Appendix 2

Portfolio Summary as at 31st October 2022

	Equity		Hedging & Insurance		Credit		Short Term Enhanced Yield		Long Term Enhanced Yield		Total		Target
	£m	%	£m	%	£m	%	£m	%	£m	%	£m	%	%
L&G	6,817	*25.5%*	345	*1.3%*	1,305	*4.9%*					**8,467**	***31.7%***	*31.5%*
Baillie Gifford	1,906	*7.1%*									**1,906**	***7.1%***	*7.5%*
Lazard	879	*3.3%*									**879**	***3.3%***	*2.5%*
Oldfield	727	*2.7%*									**727**	***2.7%***	*2.5%*
Veritas	806	*3.0%*									**806**	***3.0%***	*2.5%*
Lombard Odier	364	*1.4%*									**364**	***1.4%***	*1.0%*
JP Morgan	790	*3.0%*							877	*3.3%*	**1,666**	***6.2%***	*6.5%*
Active EM Equity	308	*1.2%*									**308**	***1.2%***	*1.5%*
Pantheon	1,604	*6.0%*									**1,604**	***6.0%***	*5.0%*
Partners Group	906	*3.4%*					258	*1.0%*	539	*2.0%*	**1,703**	***6.4%***	*6.0%*
PIMCO							1,007	*3.8%*			**1,007**	***3.8%***	*4.0%*
Ruffer							557	*2.1%*			**557**	***2.1%***	*2.0%*
Barings (multi-credit)							643	*2.4%*			**643**	***2.4%***	*2.8%*
Oak Hill Advisors							465	*1.7%*			**465**	***1.7%***	*1.8%*
Barings (private debt)							471	*1.8%*			**471**	***1.8%***	*1.3%*
Alcentra							355	*1.3%*			**355**	***1.3%***	*1.3%*
ICG Longbow							278	*1.0%*			**278**	***1.0%***	*1.0%*
Ashmore							380	*1.4%*			**380**	***1.4%***	*2.5%*
DTZ									2,638	*9.9%*	**2,638**	***9.9%***	*10.0%*
DIP	97	*0.4%*					114	*0.4%*	1,056	*3.9%*	**1,267**	***4.7%***	*6.0%*
Cash							255	*1.0%*			**255**	***1.0%***	*1.0%*
Total	**15,205**	**56.9%**	**345**	**1.3%**	**1,305**	**4.9%**	**4,782**	**17.9%**	**5,110**	**19.1%**	**26,747**	**100.0%**	**100.0%**
Target		**52.5%**		**1.5%**		**6.0%**		**20.0%**		**20.0%**		**100.0%**	

Appendix 3

Investment Advisory Panel Meeting 10th November 2022

STRATHCLYDE PENSION FUND

INVESTMENT ADVISORY PANEL

MINUTES OF MEETING ON Thursday 10th November 2022

PRESENT:	**Richard McIndoe**	Director
	Prof. Geoffrey Wood	Investment Advisor
	Iain Beattie	Investment Advisor
	Alistair Sutherland	Investment Advisor
	David Walker	Hymans Robertson
	Nell McRae	Hymans Robertson
	Jacqueline Gillies	Chief Investment Officer
	Richard Keery	Investment Manager
	Ian Jamison	Investment Manager

1. Minutes from Last Meeting & any Matters Arising

The minutes of the Panel meeting on 11th August 2022 were agreed to be an accurate record.

At its March meeting, the Committee had approved the Panel's recommendation that the Fund should switch its investment from the PIMCO PARS 3 fund to the PIMCO Dynamic Bond Fund. The transition between the two funds was completed in 3 tranches during Q3 2022.

2 Monitoring

2.1 Market and Inflation Update

The Panel reviewed investment market and inflation updates from Hymans Robertson. The Panel acknowledged the difficult market conditions, but agreed that the Fund is well diversified, and that this diversification should continue to be beneficial in providing resilience in volatile markets. A review of investment strategy will take place following the Fund's next actuarial valuation as at 31st March 2023.

2.1 Quarterly Investment Performance Review (Main Fund)

The Fund's return for Q3 2022 was negative **(-1.4%)**, and marginally below benchmark **(-0.4%)**. Performance for the year to 30th September 2022 was negative **(-5.2%)** and below benchmark **(-3.1%)**. Both absolute and relative performance are positive over the three and five-year periods.

2.2 Manager Ratings

Current officer assessments of the Fund's investment managers had been circulated, together with Hymans Robertson's manager update. The Panel discussed the ratings. On a Red, Amber, and Green (RAG) analysis:

- 17 of the Fund's managers were rated **green**
- 4 rated **amber**
- None **red**

The investment period of the Fund's separately managed account with Alcentra had been suspended in September 2021 following the departure of key personnel from the firm. Earlier this year, Alcentra announced the sale of the business by its parent company, BNY Mellon, to Franklin Templeton and this completed on 1st November 2022. The Panel will continue to monitor the impact of corporate changes and keep the suspension decision under review.

2.3 Direct Impact Portfolio Monitoring Report

The Panel reviewed the quarterly monitoring report for the Direct Impact Portfolio (DIP). Overall the portfolio and most of its investments are progressing well. On a Red, Amber, Green (RAG) analysis:

- **49** investments are rated **green**
- **4** are **amber**
- **4** are in legals
- **None red**.

2.4 Overseas Currency Hedge

In September 2017, the Strathclyde Pension Fund Committee agreed that the Fund would hedge 33% of its currency exposure arising from overseas equity by switching investments in LGIM passive index funds to currency hedged alternatives. In March 2021, as part of the Fund's triennial review of investment strategy, the Committee agreed to maintain this currency hedging strategy.

The Panel reviewed a monitoring report that indicated:

- The Fund's overseas hedge ratio at end September 2022 was 32.6% vs its target of 33%.
- The currency hedge had detracted from investment performance in the 12 months to 30 September 2022 because of the depreciation in Sterling versus the US dollar, and to a lesser extent due to Sterling depreciation against other major currencies.
- Since the inception of the hedging strategy, total Fund gains from currency had been reduced mainly as a result of the depreciation of Sterling against the US dollar.

The Panel remain supportive of the current hedging target weight of 33% of overseas listed equity. The strategy will be considered as part of the 2023/24 review of Investment Strategy.

2.5 Estimated Funding Levels

The Panel reviewed a quarterly funding update report provided by Hymans Robertson. The funding level had increased significantly after the 31st March 2020 actuarial valuation as a result of strong investment returns, and had increased further during 2022 as a result of increasing bond yields. The level was particularly volatile towards the end of September as a result of market turbulence, but had remained comfortably above 130% throughout the quarter.

3 Allocation

3.1 Private Market Allocations

The Panel reviewed a schedule of estimated cash flows for the Fund's private market investment programmes - private equity, global real estate, the Direct Impact Portfolio, and private debt commitments. Totals at 30th September 2022 were as follows.

	2022 Estimate (£m)	**2022 Actual YTD (£m)**
Distributions	678	523
Calls	-799	-544
Net	**-121**	**-21**

Forecasted net drawdowns in 2022 have increased since last quarter:

- Private debt managers Partners Group and ICG Longbow continue to build their portfolios towards the Fund's strategic target allocation. Drawdowns to these investments, and to the Direct Impact Portfolio, are still expected to exceed distributions.
- Drawdowns to the Partners Group private real estate mandate will exceed distributions, though net cash out flows will be **£26m** less than previously forecast.
- The Pantheon private equity and the Partners Group private equity programmes are mature portfolios.
  - Pantheon anticipate that distributions will exceed drawdowns in 2022, but by **£40m** less than previously indicated.
  - Having previously predicted that distributions will exceed drawdowns, Partners Group now predict higher drawdowns to, and lower distributions from, the Fund's private equity portfolio, resulting in a net cash out flow in the year **(+£20m** forecast at end June 2002 vs **-£34m** forecast at end September 2022).
- The Barings private debt portfolio is above target allocation and is now returning capital back to the Fund.
- The investment period for the Alcentra SMA has been suspended; Distributions from this portfolio, and Alcentra EDL II and III, will exceed drawdowns.

The Fund's central cash balance at 30th June 2022 was £325m. This represented a net increase of £55m in the quarter as:

- £82m was draw down to, and £123m distributed from, private market programmes, with the remaining difference in cash balances accounted for by foreign currency gains and timing differences between the receipt of distributions into individual manager accounts and transfers back into central cash.
- In the first half of September 2022, the Fund divested the £347m cash held in L&G's Sterling Liquidity Fund over 3 weekly dealing dates. Proceeds were switched into L&G's 0-5 year UK gilt fund, in accordance

with the conclusion of the review of the Fund's relative value framework at the August meeting of the Investment Advisory Panel.

3.2 Rebalancing Strategy

The Panel reviewed a re-balancing report as at 30th September 2022.

- Equity allocation was above target weight (55.4% vs 52.5%) but within the upper target range (42.0% to 63.0%). At levels 2 and 3, all mandates were within their target ranges.
- The Fund's allocation to Hedging and Insurance was under target weight (1.3% vs 1.5%) but within target range.
- The Fund's allocation to Credit was under target (4.9% vs 6%) and outwith target range (5% to 7%).
- The Fund's allocation in STEY was under target weight (16.9% vs 20%) and within target range for this asset class when central cash balances are taken into account. At level 2, the Fund's allocation to emerging market debt (1.4% vs 2.5%) was below target and below the lower target range.
- The Fund's allocation in LTEY was below target weight (18.6% vs 20%) but within the target range (17.5% to 22.5%). At level 3, the DIP LTEY portfolio was at the upper limit of its target range (4%) while the Partners Group real estate portfolio was below its target allocation (2.0% vs 2.5%) and at the lower limit of its target range (2.0% to 3%).

The Panel discussed current allocations and commitments and agreed

- that it would not be appropriate to allocate more money to emerging market debt due to poor performance of the mandate.
- New commitments should bring the Partners Group real estate portfolio back within target range.
- The credit portfolio should be brought back to within its target allocation, in accordance with the latest relative value assessment (see 3.3 below).

Finally, the Panel noted that the commitment of an additional £140m to the JP Morgan International Infrastructure Fund remained outstanding at the end of September, with draddown of the full amount now expected at the start of January 2023. £140m has already been divested from the L&G market cap portfolio and held in cash to cover the commitment, but in light of the increase in predicted drawdowns to private market programmes during the remainder of 2022, the Panel agreed that:

- it would be prudent to increase the Fund's cash balance in the run up to year end; and
- as the Fund was overweight its Equity allocation and the target allocation to two global equity managers, Lazard and Veritas, the Fund should divest £50m each from these portfolios and hold proceeds in cash.

3.3 Relative Value Framework

The relative value framework had been introduced to generate additional value and reduce the risk of capital losses by varying implementation of the 7.5% allocation held in protection assets. Decisions to move away from the strategic – or neutral - allocation of 6% Credit (50/50 UK/US investment

grade) and 1.5% Hedging and Insurance (index-linked gilts) allocation are based on pre-defined metrics.

The quarterly relative value report from Hymans Robertson provided the following summary assessment of metrics as at 31st October 2022:

- Sterling A grade credit spreads had increased, rising well above long-term median levels, indicating that the Fund should retain its credit holdings.
- Implied interest rates looked at least fairly priced out to 20 years or so, with the framework suggesting a preference for gilts over cash.
- The preference for gilts over cash was outweighed by the widening of credit spreads, which indicated that the Fund should sell its holdings in UK gilts to fund purchases in corporate bonds and move the Fund to an overweight position in credit.

The Panel discussed the report's assessment of the latest metrics and agreed that the Fund should retain its current credit holdings and switch its gilts holding at L&G into credit.

The switch out of gilts would move the Fund's credit position back towards its central Credit target of 6% of total Fund but would not be enough to attain an overweight position. The Panel therefore reviewed the position of other investment strategies relative to their respective target allocations. The Fund was overweight its allocation to Equities overall and to the L&G RAFI portfolio at the end of Q3 2022. The Panel agreed that 0.9% of Fund (£230m) should be switched out of the RAFI portfolio and into corporate bonds, bringing the RAFI portfolio back to target while increasing the corporate bond portfolio to an overweight position.

4. Investment Strategy and Structure

4.1 Climate Change: Net Zero Action Plan

The SPF Committee had agreed a climate change strategy for the Fund focussed on achieving net zero by 2050.

At its meeting in March 2022, the Committee agreed that the Fund should join the Paris Aligned Investment Initiative (PAII) and use the IIGCC Net Zero Investment Framework as the basis for producing a climate action plan that would meet an interim target for carbon reduction of at least 45% from the Fund's baseline by 2030. The production of a climate action plan for approval by Committee in Q1 2023 is a priority in the 2022/23 SPF business plan.

A first draft of a climate action plan for the Fund based on the IIGCC Net Zero Investment Framework had been circulated to the Panel for review. Officers will progress and finalise the plan in time for review by the Committee at its March 2023 meeting.

4.2 Net Zero Investment Framework

At the August Panel meeting, Hymans Robertson had presented a paper summarising their approach to a net zero strategy consistent with the IIGC

framework together with examples of other clients' targets and implementation of net zero plans.

In support of clients' climate strategy objectives, Hymans' approach includes forward looking analysis, the aim of which is to make judgements as to the extent to which individual portfolios are aligning with net zero. To illustrate this approach, Hymans had prepared a paper which compared 3 of the Fund's equity mandates' emission levels and transition pathways to those envisaged by the Intergovernmental Panel on Climate Change (IPCC) for the world to have a 2/3s probability of remaining below an overall temperature increase of 1.5 degrees Celsius over pre-industrial levels.

The Panel agreed that this analysis could be useful in support of the Fund's own climate change objectives and that officers should continue to work with Hymans to develop the metrics and analyses that will help inform the implementation of its climate action plan.

4.3 Investment Strategy and Structure Review 2023/24

A review of investment strategy will be carried out in conjunction with the actuarial valuation of the Fund as at 31st March 2023.

Implementing a net zero investment strategy will be a key focus of this review. In addition, the Panel agreed that a review of the STEY structure and investment strategies and future fixed income positioning should form part of the review.

5. Governance

5.1 Strathclyde Pension Fund Committee.

The Panel noted the draft agenda for the next committee meeting on Wednesday 23rd November 2022.

6 Manager Reviews

The following investment managers attended the Investment Advisory Panel:

- **Partners Group**
- **Lombard Odier**
- **Veritas**

Performance of each of the managers was reviewed.

Partners Group

The Partners Group private equity portfolio is currently valued at £889m – 3.4% of Fund versus a target weight of 2.5%. The private real estate portfolio is currently valued at £527m – 2.0% of total Fund versus a target weight of 2.5%. The private debt portfolio is currently valued at £251m – 1.0% of total Fund versus a target weight of 1.0%. Partners Group updated the Panel on the performance of the Fund's private equity, private real estate and private debt investments.

Private Equity and Private Real Estate

In order to maintain its target investment allocations, the Fund had previously agreed commitment plans for the private equity and real estate programmes, divided into annual investment 'tranches' between the years 2019 to 2022.

The private equity portfolio is currently over the Fund's target weight and as a result, no new commitments were made in 2021. Partners project that the 2020 investment tranche will be fully committed in 2022. Their cash flow modelling of the private equity portfolio demonstrates that distributions from the portfolio should bring the it back in line with the Fund's target allocation in 2023. Thereafter the portfolio value is expected to fall below the Fund's target weight. Partners Group proposed a 2022 commitment of £100m in order to maintain the portfolio's value at the Fund's target weight in 2024 and 2025.

The private real estate portfolio is currently under target weight. Last year, Partners Group recommended additional commitments of £200m per annum in 2021/22 and 2022/23 in order to reach and maintain target exposure. These commitments were agreed by the Panel.

Partners current cash flow modelling demonstrated that in order to maintain the Fund's target allocation beyond 2025, the 2022/23 commitment should be increased from £200m to £300m.

Private Debt

The private debt portfolio is almost fully invested but the current environment represents an attractive investment opportunity amid rising rates. As limited refinancing activity is anticipated within the Fund's existing portfolio, Partners proposed an additional commitment of £260m.

The Panel considered the new investment proposals for both private equity, real estate and private debt and agreed the following:

- The Fund should proceed with a top up commitment of £100m to private equity to maintain this portfolio's allocation at its target level.
- The Fund should proceed with the second (2022/23) £200m top up commitment to private real estate as agreed by the Panel last year.
  The Fund still has substantial unfunded commitments to this programme and so the Panel agreed to review the requirement for any further commitments over and above the 2022/23 commitment tranche next year, rather than agree at this time.
- The Partners Group private debt portfolio is at target weight and is an evergreen fund. The Panel agreed that no new commitments were therefore required at this time.

Lombard Odier

The Lombard Odier UK Smaller Companies equity portfolio is currently valued at £356m, or 1.4% of total Fund, versus a target weight of 1.0%. Lombard Odier provided an update on the current portfolio, performance and investment markets together with an outline of their approach to climate change and net zero.

Appendix 3

Investment Advisory Panel Meeting 10th November 2022

Veritas

The Veritas global equity portfolio is currently valued at £793m, or 3.0% of total Fund, versus a target weight of 2.5%. Veritas provided an update on the current portfolio and performance together with an outline of their approach to climate change and net zero.

Appendix 4

Stewardship: Responsible Investment Activity Q3 2022

Responsible Investment: Quarter 3 2022
A summary of activity against each of the six United Nations Principles for Responsible Investment is provided below.

1. We will incorporate Environmental, Social and Governance (ESG) issues into investment analysis and decision-making processes

In quarter 3, the Fund's property manager, **DTZ Investors**, provided a report on the results from the 2022 Global Real Estate Sustainability Benchmark (GRESB) Annual Real Estate Assessment. GRESB assesses ESG performance at the asset level for real estate operators, fund managers and investors that invest directly in real estate. The assessment offers high-quality ESG data and advanced analytical tools to benchmark ESG performance and identify areas for improvement.
The 2022 GRESB real estate benchmark saw 1,820 entities participate across 74 countries, covering $7.4trn. This represented the largest year on year growth in entities since GRESB began. Within the UK over 260 entities participated and 80 of these were within SPF's peer group.
Key takeaways from the 2022 report include:

- A score of 70 in the 2022 submission, an increase of 6 marks compared to the previous year. This has brought the SPF portfolio in line with the peer average and demonstrates a significant improvement in performance.
- 30 out of 30 score in the management section, demonstrating that a clear governance structure is in place to manage ESG.
- The performance score saw a significant increase this year with 40 out of 70 achieved. The key aspects within the performance section include energy consumption, GHG emissions, water use and waste management, which make up 32% of the overall GRESB score. Tenant emissions make up over 90% of the overall footprint and so capturing tenant data is critical to achieving and maintaining high GRESB scores. In 2022, a large focus on tenant engagement and tenant data capture enabled significant improvements in these areas and this will continue to be a priority in 2023.

DTZ Investors also reported that to further support their commitment to net-zero, they have become a signatory of the **Better Building Partnerships Climate Commitment**. As a signatory, DTZ Investors commit to publishing progress against the net-zero target, develop comprehensive climate resilience strategies and support the development of best practice within the sector. Commitments such as these are crucial to ensure that net-zero can be delivered at both a sector and global scale and further reinforces DTZ Investors' strategy to have an impact beyond the Four Walls of their real estate.

2. We will be active owners and incorporate ESG issues into our ownership policies and practices

Appendix 4

Stewardship: Responsible Investment Activity Q3 2022

2.1 Voting

Managers' voting activity during the quarter to 30th September 2022 is summarised as follows.

Voting activity to 30th September 2022		
		(%)
Total meetings	**1,037**	
Votes for	8,100	82
Votes against	1,650	16
Abstentions	51	1
Not voted	58	1
No. of Resolutions	**9,859**	**100**

Voting activity in the quarter included:

- **Baillie Gifford** successfully opposed executive compensation at US medical device technology company **Abiomed Inc.,** due to concerns with the structure of the plan including short term performance targets within the long-term plan. (resolution opposed by 64%). At **Tesla Inc.** Baillie Gifford supported a resolution requesting additional disclosure on the company's efforts to address harassment and discrimination in the workplace. Quantitative disclosure would help shareholders understand and monitor the company's efforts (resolution received 47% support). Also at Tesla, Baillie Gifford opposed a shareholder resolution requesting a report on how the company's corporate lobbying is aligned with the Paris Climate Agreement. Given Tesla's core mission is to accelerate the world's transition to sustainable energy and its entire business strategy is in alignment with the Paris Agreement, additional disclosures would be a burdensome with no real benefit to shareholders (resolution opposed by 65%). At Switzerland-based luxury goods holding company **Richemont**, Baillie Gifford opposed a management resolution to approve variable remuneration for the executive committee due to a lack of clarity and clear alignment with shareholder interests. (resolution received 75% support).

- **Legal & General** voted against a resolution to approve the climate strategy at financial services company **Ninety-One Plc.** This was a management proposed 'Say on Climate' vote, relating to the net zero transition. Legal & General believed the proposed strategy did not go far enough. Legal & General expects companies to introduce credible transition plans, consistent with the Paris goals of limiting the global average temperature increase to 1.5°C. This includes the disclosure of scope one, two and material scope three GHG emissions and short, medium and long-term GHG emissions reduction targets consistent with the 1.5°C goal. (resolution received 98% support). Legal & General voted against the re-election of a director at **Royal Mail Plc.** due to a lack of gender diversity on the executive committee. Since 2022, Legal & General have applied voting sanctions to the FTSE 100 companies that do not have at least one woman on their executive

committee, with the expectation that there should be a minimum of 33% over time (resolution received 93% support).

- **Oldfield Partners** voted against remuneration for executive officers at **BT Group** in response to an adjustment to the long-term incentive plan for extra capex the company did not foresee at the time the plan was approved.

- In Germany, **Lazard** voted against ratifying named executive officers' compensation and the remuneration report at **Linde Plc.** Lazard also voted against a range of executive remuneration resolutions at **NIKE, Inc**., in the US and French spirits group **Remy Cointreau SA**.,

- **Lombard Odier** voted against executive remuneration at **Norcros Plc.** The quantum of the raises is excessive and without supportive rationale. The remuneration report was opposed at **Ted Baker Plc.** Despite the continued use of the furlough scheme in FY2021/22, the Company paid bonuses to executives and has not yet repaid the furlough loans. At **Fulcrum Utility Services Ltd.** Lombard Odier voted against approving the remuneration report as the Company has not provided an explanation in the annual report for the payment made to the former CEO as compensation for loss of office; and the annual report does not include a clear breakdown of the individual remuneration components paid to the Directors during the year under review. The remuneration report was also opposed at **DWF Group Plc.** as the dilution limit of 10% is being exceeded with the outstanding share awards at over 12%. Lombard Odier also voted against the re-election of Malcolm Groat as Director at **Harland & Wolff Group Holdings Plc**: He is over boarded and can't possibly give appropriate attention to each of his positions.

- At **Cosmos Pharmaceutical Corporation** in Japan, **JP Morgan** voted against a proposed amendment to articles of association to authorize the board to determine income allocation without shareholders' approval. The company believed it would be beneficial to receive an earlier dividend payment and it could also prevent non-payment of dividend when AGM is not held such as in case of the pandemic. A vote against was warranted as the significance of the shareholders' approval process at the AGM should be weighted more than the timing of dividend payments.

2.2 Engagement

Engagement highlights during the quarter include the following.

- **Baillie Gifford** engaged with the **Ryanair Holdings plc**. board and its head of sustainability to discuss a range of environmental, social and governance topics. The discussion with the chair and senior independent director focused on board succession. They are actively reviewing board skills to identify gaps as they are preparing for upcoming

board refreshment. There are several directors on the board who, given their tenure, are likely to retire in the next three to five years, and preparations are being made now. Broadening industry and international experience were mentioned as desirable enhancements, which Baillie Gifford agreed with. Executive remuneration was also discussed as the board is in the process of negotiating with the CEO to renew his contract. The meeting with the head of sustainability focused on developments relating to sustainable aviation fuel (SAF). Two deals made by Ryanair and fuel producers regarding SAF have recently been announced. The company is hosting a day later in the year dedicated to discussing SAF. Various stakeholders within the industry (fuel producers, aircraft manufacturers and academics) will gather to update investors on the long-term prospects of the fuel within the industry.

Baillie Gifford met with head of investor relations at **The Trade Desk, Inc.**, to begin a dedicated conversation on their potential for positive climate impact. The first part of the discussion focused on The Trade Desk's own climate basics. The company is getting ready to disclose its own direct emissions and is thinking about long term renewable energy purchasing and plans for net zero. While Scope 3 boundaries are a challenge the potential for broader system influence was discussed. The company is seeing clear client and supplier focus on 'climate quality', which brings a focus on ad content and placement. The company has already set quality standards for political advertising and sees scope to extend and apply these in the climate space. As expected, The Trade Desk is thoughtful and open about its thinking and approach to climate, which goes beyond its own operational emissions. Baillie Gifford need to keep the conversation going as the company considers a clear public stance.

Baillie Gifford engaged with the head of corporate sustainability at **Wayfair Inc.,** as part of an ongoing engagement on the company's environmental impacts and ambitions. Baillie Gifford identified Wayfair as a climate and environment engagement priority back in 2020. As a platform aggregating and matching the (primarily) furniture products of over 23,000 suppliers, many from Asia, with millions of customers, mostly in the US and Europe, it has huge potential for positive influence. Its levers run across raw materials and durability, through logistics, to customer choice and, ultimately, reuse or disposal. Management recognises the potential and is working on supplier education and have introduced some sustainability labelling for consumers. However, it seems a landscape that is still very fragmented and lacks sufficient regulatory frameworks. This was a useful follow-up to a meeting with the CEO in June. It was a working exchange of ideas covering emissions reporting, the evolution of low emissions, freight, supplier engagement and customer influence. Baillie Gifford will continue the conversation into 2023.

- **Legal & General** engaged with **Toyota Motor Corporation** (TMC), to seek improvement in their corporate governance and sustainability practices. Legal & General met with Toyota earlier this year to discuss

climate change, board composition and capital allocation. Legal & General expressed concerns around the company's cross shareholdings, the lack of supervisory function at the board level given the low level of independence, and the company's climate transition strategy and related public policy engagements. Given the company's size and influence at Japan's largest business federation and in industry associations, Legal & General have always questioned the company's lobbying stance and its alignment with a 1.5°C world (this is a red line under sector guides for the auto sector in the Legal & General Climate Impact Pledge). Legal & General are delighted to see improved transparency from the company when they published their climate policy late last year. Nonetheless, corporate transparency is only the first step and Legal & General hope that this will enable more in-depth conversations on Toyota's views on climate and how the company plans to shift its strategy. Given a recent controversy at one of Toyota's group companies (Hino*), Legal & General will continue to engage with the company on corporate governance issues and push for better practices both in terms of corporate governance and climate strategy.

- During the quarter **Oldfield Partners** accelerated activity on the engagement campaigns that they set for the year. These are focused on achieving thirty percent female representation on boards, as well as effective disclosure of greenhouse gas emissions, and a science-based Net Zero target. With a 75% response rate, Oldfield were encouraged by the level of interaction and feedback with companies on the topic of female representation on their Boards. With 11 of the 23 investee companies targeted not yet meeting a target of 30% they engaged with 8 of them during the quarter. These included **Samsung Electronics, Nomura** and **Southwest Airlines**. Oldfield learnt that several companies are either close to this objective, actively looking to address the issue in the natural cycle of board turnover or improving and leading within regions where average representation is far below the target, for example in Japan. For these reasons, Oldfield have not adopted a blanket approach to voting on this issue, instead continuing to push on collaborative discussions and providing feedback on voting decisions and timeframes for progress. Oldfield also engaged with 10 companies on climate related issues. They initially focused on the 5 companies that have yet to make a public commitment to Net Zero by 2050, including **NOV, Alibaba** and **ENI.** Oldfield then turned their attention to targets that are not yet science-based, and in this second category they prioritised the companies with the highest impact on real world emissions, or where they believe they can add value these included **Southwest Airlines** and **MUFG**.

- **JP Morgan** engaged with **Dunelm**, the UK based home furnishing retailer. The meeting addressed a broad range of ESG topics, including employee wellbeing and engagement, sustainability, diversity, labour, and environmentally friendly sourcing of materials. The discussion with the CEO, CFO, and Investor Relations confirmed that the company has

begun training its managers on supporting employees physical, mental, and financial wellbeing. JP Morgan noted strong detailing and reporting regarding employee engagement, which was a positive sign. The company's efforts on diversity are also constructive – notably, that most executives are women. Areas of improvement include better transparency of labelling and sustainable product use – reportedly, the company have wanted to pursue this for several years but have only now got around to it. Additionally, JP Morgan asked the company to disclose staff turnover to check their claim that employee retention was strong versus industry peers. Lastly, JP Morgan wanted to make sure that ethical sourcing had been rolled out further down their supply list, in that all Tier 1 suppliers also disclosed ethical sourcing with their respective Tier 2 suppliers. JP Morgan will follow up with management to keep the company accountable regarding sourcing and labelling and ensure, with the help of an external auditor, that there are no ongoing child labour practices in any of their supplier partner networks.

- Global High Yield Credit manager **Barings** engaged with a global automotive manufacturer that is currently excluded from mandatory emissions reductions under European legislation. From 2030, the company is expected to be captured by regulatory requirements in line with larger automotive OEMs. Barings views this as a credit risk for the company given its potential to impact demand dynamics and upcoming capital investment requirements. The company previously carried a 4 Poor / Stable Outlook environmental rating under Barings' ESG ratings methodology. During multiple interactions directly with the company's senior management representatives, Barings requested improvements to governance of environmental risks and the implementation of specific emissions reduction targets. In April 2022, the company announced its commitment to the Science Based Targets initiative (SBTi) Net-Zero Standard. The business is now targeting a net zero manufacturing footprint by 2030 and a net zero supply chain by 2039. The company also announced a path towards electrification with the launch of its first plug-in hybrid vehicle expected in 2024 and the first fully electric vehicle in 2025. The success of this engagement gave Barings comfort continuing to hold investments in the company's debt facilities and resulted in an upgrade to Improving Outlook for the environmental ESG rating.

2.3 We will seek appropriate disclosure on ESG issues by the entities in which we invest

Improved disclosure is a recurring theme of engagements with portfolio companies by investment managers and Sustainalytics.

- **JP Morgan** met with **Beazley**, the UK-based specialist insurer, to seek disclosure on how the company is incorporating climate risk into underwriting and to know more about the eligibility criteria they use. The company confirmed that qualification is based on scores from S&P,

Sustainalytics or RepRisk and that they currently do not offer a discount for clients with a better ESG score. In terms of estimating climate risk, the company is building tools to look at this and is set to make further progress this year. Beazley currently has a 2050 Net Zero target, together with near-term reduction targets. However, JP Morgan anticipate more disclosure, especially Science Based Targets, which they are building out now. JP Morgan questioned the company around their carbon reduction targets for this year and next year and expect them to look at formalised five-to-ten-year net zero targets.

- **Baillie Gifford** met with the stock exchange located in São Paulo, Brazil**, B3 S.A.,** to learn more about the company's sustainability ambitions. Baillie Gifford wanted to speak to B3's sustainability team to understand the drive behind its efforts. They also wanted to know how the overall exchange integrated ESG into strategic decision-making, understand the appetite for ESG products in Brazil, and ask the team what it thought the future of ESG in the region looked like and what its role was supporting its development. B3 outlined its sustainability strategy, emphasising that the exchange recognised its role and responsibility to promote ESG but that currently, in the market, a lack of data was pervasive and hindering more widespread adoption. Gender inequity, generally, would appear to be a strategic priority for B3. In 2021, the exchange became the world's first to issue a Sustainability Linked Bond. It is committing to the creation of a diversity index for the Brazilian market to promote companies listed to set gender in leadership diversity and other (yet to be defined) targets by 2024 and increasing the percentage of women in leadership positions within the exchange to 35 per cent from 2020's 27.2 per cent baseline by 2026. B3 are also working on developing a carbon market - the exchange estimating Brazil could provide for 15 per cent of the global offset market. While not a material issue for the exchange, Baillie Gifford wanted to understand why it had chosen to use 2021 as a baseline. In 2021, Brazil's grid intensity spiked owing to a drought (~64 per cent of Brazil's electricity comes from hydropower) causing B3's own scope 2 emissions to rise approximately 114 per cent year-over-year. B3's 15 per cent reduction target by 2026 uses this outlier year as a baseline. Baillie Gifford encouraged B3 to review its use of this baseline, as achievement of the target would not amount to meaningful emissions reductions. B3 did agree to review use of 2021 for their scope 2 target and Baillie Gifford have been invited to support the development of its 'climate roadmap'. The conversation with B3's sustainability team will continue later in the year, following COP27, for an update on initiatives - namely its work on carbon markets. Baillie Gifford will also look to better understand B3's ESG ambitions and its integration into strategic decision-making in upcoming meetings with senior leadership.

2.4 We will promote acceptance and implementation of the Principles within the investment industry

- Currently all the Fund's investment managers are signatories to the principles and 32 of the 33 managers within the Direct Investment Portfolio are also signatories. The Fund strongly encourages managers to become signatories and to adhere to the principles. However, for some this will be less appropriate due to the specialised nature of their activities.

- In quarter 3, the Fund received its results from the **2021 PRI survey**. The annual PRI assessment report is compulsory for all asset owner and investment manager signatories and demonstrates how a signatory has progressed in its implementation of the Principles year-on-year. The Fund continues to perform in the top tier of global PRI signatories and achieved a maximum overall 5 stars and the following scores from 4 assessed modules.
  - Investment and Stewardship Policy: 85 out of a maximum 100.
  - Listed equity Passive: 93 out of a maximum 100.
  - Real Estate: 94 out of a maximum 100.
  - Listed equity Active: 87 out of a maximum 100.

- The Fund is a signatory the new **UK Stewardship Code** (2020). The Fund also encourages its external investment managers and service providers to demonstrate their commitment to effective stewardship by complying with the UK Stewardship Code. Currently fourteen of the Fund's investment managers and consultants Hymans Robertson and Sustainalytics are signatories. The full list of signatories to the Code is available at: https://www.frc.org.uk/investors/uk-stewardship-code/uk-stewardship-code-signatories.

2.5 We will work together to enhance our effectiveness in implementing the Principles

The Fund seeks to improve the effectiveness of company engagement and voting by acting collectively with other institutional investors, charities, and interest groups. Working with ShareAction and others, the Fund has carried out direct collaborative engagement across a range of initiatives. It is also a member of industry collaborative forums including the Local Authority Pension Fund Forum, the Institutional Investors Group on Climate Change and the Carbon Disclosure Project (CDP).

- The Local Authority Pension Fund Forum (LAPFF) provided a Quarterly Engagement Report. The report highlights include:

  - Engagement with **Mizuho** to determine how the company was progressing its work on carbon emission reductions and on the transitional pathway and strategy Mizuho has developed to achieve these targets.

Appendix 4

Stewardship: Responsible Investment Activity Q3 2022

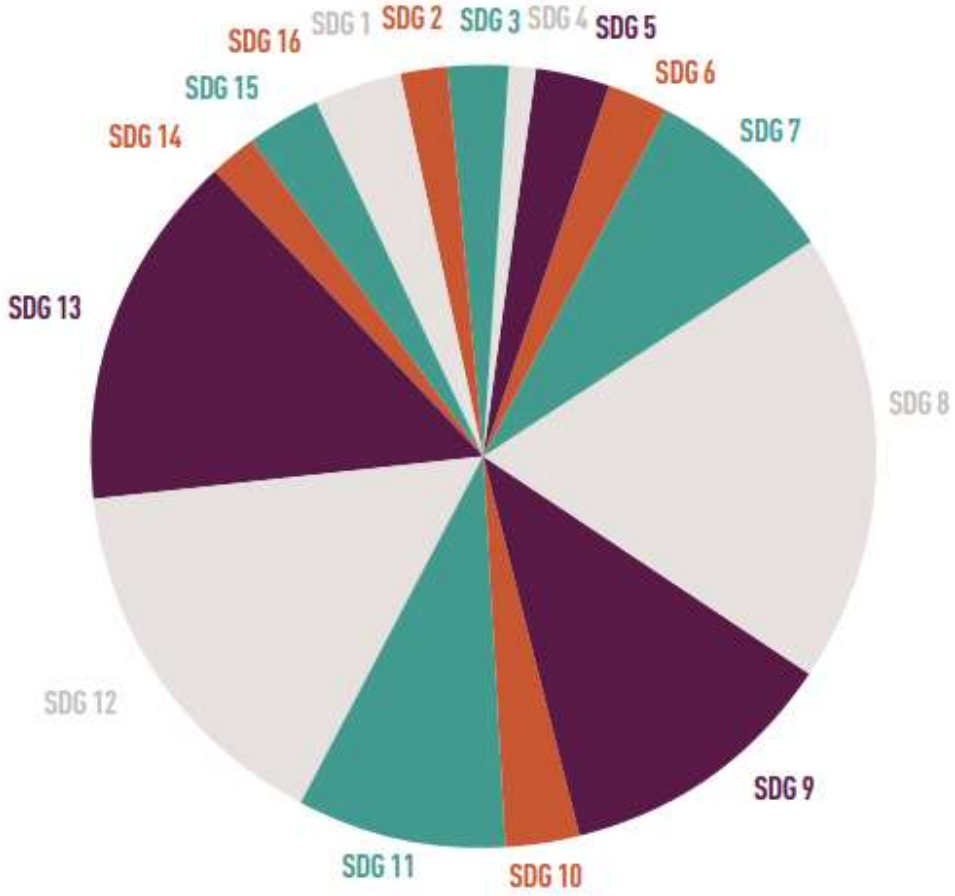
- LAPFF issued a voting alert ahead of the **SSE** AGM. LAPFF previously advised members to abstain on whether to improve the company's net zero transition report in 2021 due to concerns about important omissions related to Scope 3 emissions, capital allocation and alignment with Paris Agreement targets.
- Engagement with **Ford Motors** to discuss its approach to human rights and responsible mineral sourcing**.**
- LAPFF has continued to investigate issues of Uyghur forced labour in Xinjiang and other regions of China. After two engagements with companies earlier in the year, LAPFF has been looking at potential ways forward through collaborative engagement on the issue.
- Following meetings with **Sainsbury** in Q1 and Q2 2020, LAPFF has maintained an interest in **ShareAction's Good Work Coalition** which looks at the living wage and insecure work, amongst other issues.
- LAPFF joined a collaborative call, organised by **ShareAction**, with **Marks & Spencer** representatives to discuss the company's approach to pay.
- LAPFF continued its support for **Rathbones' Votes Against Slavery** and other engagements on modern slavery. It has also volunteered to lead on upcoming company engagements with **CCLA's 'Find It, Fix it, Prevent It'** engagement, which seeks out companies to identify issues on modern slavery in their supply chains more proactively.
- LAPFF continued engagement on the role food producers play on public health and in August met with **Kellogg's** for the second time under this engagement.
- In support of the **30% Club Investor Group** LAPFF joined several investors in writing to three companies, **Charter Communications, Liberty Media** and **Transdigm Group**. To start a global engagement looking at laggards on gender board diversity in the USA
- LAPFF Chair, Cllr Doug McMurdo spent three weeks in **Brazil** this quarter investigating the situation of communities affected by tailings dams in Conceição do Mato Dentro, Mariana, and Brumadinho. This trip was part of LAPFF's broader work on mining and human rights. The context for the trip is available in the mining and human rights report LAPFF published in April 2022.

The LAPFF Quarterly Engagement Report is available at: https://lapfforum.org/publications/category/quarterly-engagement-reports/

LAPFF map their quarterly engagement cases to the **United Nations Sustainable Development Goals** (**SDGs)** as illustrated in the chart below.

Appendix 4

Stewardship: Responsible Investment Activity Q3 2022



LAPFF SDG ENGAGEMENTS	
SDG 1: No Poverty	2
SDG 2: Zero Hunger	3
SDG 3: Good Health and Well-Being	4
SDG 4: Quality Education	2
SDG 5: Gender Equality	5
SDG 6: Clean Water and Sanitation	4
SDG 7: Affordable and Clean Energy	13
SDG 8: Decent Work and Economic Growth	30
SDG 9: Industry, Innovation, and Infrastructure	19
SDG 10: Reduced Inequalities	5
SDG 11: Sustainable Cities and Communities	14
SDG12: Responsible Production and Consumption	25
SDG 13: Climate Action	24
SDG 14: Life Below Water	3
SDG 15: Life on Land	5
SDG 16: Peace, Justice, and Strong Institutions	4
SDG 17: Strengthen the Means of Implementation and Revitalise the Global Partnership for Sustainable Development	0

The **2030 Agenda for Sustainable Development**, adopted by all United Nations Member States in 2015, recognised the private sector as a key agent in addressing global challenges such as climate change, poverty, environmental degradation and inequality. Meaningful SDG strategies aligned with companies' business plans can link profit with sustainability and contribute to a more stable and sustainable world.

LAPFF also provided responses to consultations and calls for evidence during the quarter including:

- a UK government Transition Plan Taskforce (TPT) call for evidence on private sector transition plans. Launched by HM Treasury, the TPT aims to help financial institutions and companies prepare rigorous transition plans.
  LAPFF's response draws upon the Forum's experience of engaging with private sector companies on climate plans and a just transition and sets out expectations that there should be a principle-based transition plan template. Different sectors can then apply existing and developing guidance in identifying risks and opportunities, and setting strategy, targets and timeframes aligned with remaining objectives within the scientifically identified global carbon budget. Principles that LAPFF wishes to see embedded include coverage of Scopes 1-3 emissions, inclusion of short, medium and long-term targets; a focus on actual emission reductions (real zero) rather than offsetting and carbon capture (net zero); and the inclusion of the social dimension, aiming for a fair and just transition. The TPT will initially report by the end of 2022

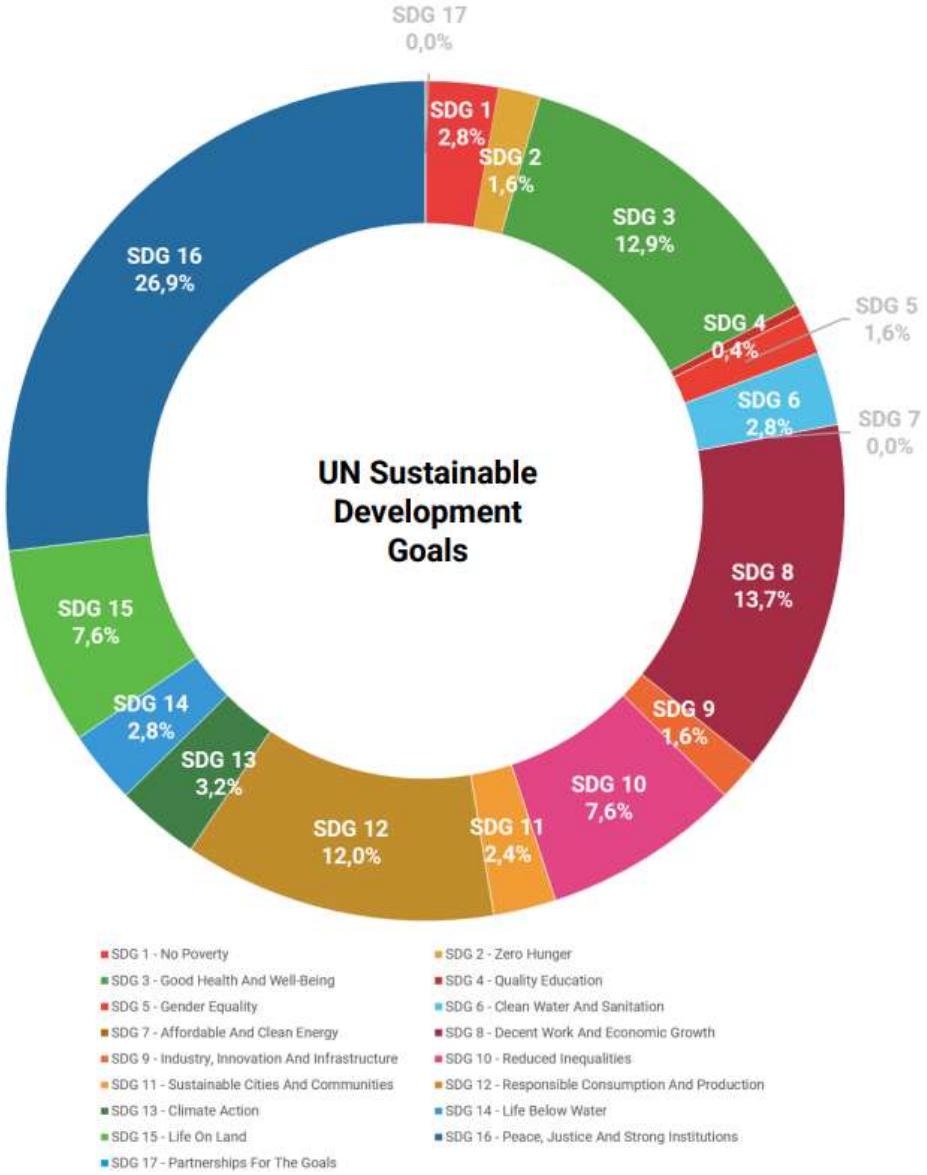
2.6 We will report on our activities and progress towards implementing the Principles

- Legal & General, Lazard, Baillie Gifford, JP Morgan, Lombard Odier, Veritas and Oldfield Partners provided reports on ESG engagement during the quarter. Sustainalytics provided a full engagement report for the quarter and an engagement progress update on individual portfolio companies.

- In quarter 3 the Fund was confirmed as a signatory (2021 annual submission) to the **UK Stewardship Code** (2020). The UK Stewardship Code 2020 is a substantial and ambitious revision to the 2012 edition of the Code and sets high stewardship standards for signatories. Organisations wanting to become signatories to the Code are required to produce an annual Stewardship Report explaining how they have applied the Code in the previous 12 months. The Financial Reporting Council (FRC) evaluates the Reports and those that meet the reporting expectations are accepted as signatories. The Fund is one of 48 asset owners to be accepted and is one of only two Scottish public sector asset owners listed. The full list of signatories to the Code is available at: https://www.frc.org.uk/investors/uk-stewardship-code/uk-stewardship-code-signatories

- **Sustainalytics** Quarterly Engagement Report summarizes the shareholder engagement activities performed on behalf of investor clients during the quarter and includes updates on individual portfolio

companies. Sustainalytics map these Global Standards Engagement cases with relevant **SDGs** (UN Sustainable Development Goals) and engagement dialogue aims to work toward achieving the sustainable outcomes. 152 Engage and Resolved cases in quarter 3 can be attributed to the following SDGs (as percentage of total cases).



- **Sustainalytics** issued a final report for the thematic engagement, **Child labour in Cocoa.**

  Ivory Coast and Ghana are the world's leading cocoa producing countries, accounting for almost 70% of cocoa production worldwide. However, it is estimated that in these countries combined, over 1.5 million children work in hazardous conditions in the cocoa supply chain alone.

  This issue is not new, but it is persistent. The Harkin-Engel protocol (a commitment from the cocoa industry to combat child labour in its supply chain) was introduced in 2001 and in 2010,

the industry reaffirmed its commitment in a joint declaration to reduce the worst forms of child labour by 70% by 2020. Various programmes aimed at increasing productivity and improving the livelihood of cocoa-growing farmers have been scaled up over the years and targeted measures to combat cases of child labour have been developed. Across the supply chain, the cocoa industry, governments and others continue to deploy significant efforts. Despite these developments, child labour remains widespread at the millions of small-scale farms involved in cocoa farming in West Africa and efforts must therefore continue, and be scaled up, so that commitments to eradicate child labour can be met.

Investee companies linked to child labour represent a reputational risk, not only for the companies themselves, but also for their investors. This is particularly the case in cocoa production, where there are widespread and well documented instances of child labour. Cocoa and chocolate companies must also secure a stable farmer base. In recent years, macro trends such as urbanization and aging farmer population in cocoa-producing countries have put a strain on the sector. To attract and retain a workforce and a stable supply, the cocoa industry needs to ensure that cocoa farming is lucrative by paying farmers adequately so that they can sustain themselves and their families.

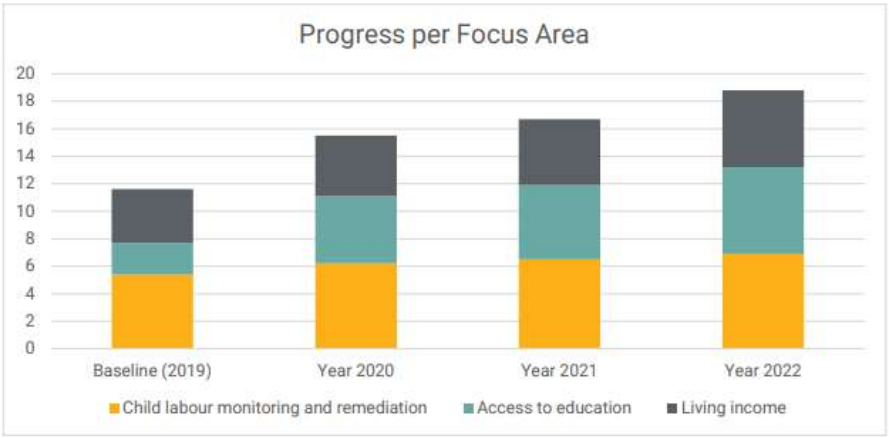
The Sustainalytics' thematic engagement on Child Labour in Cocoa started in Q3 2019. Together with a group of more than 30 institutional investors, they engaged major cocoa and chocolate companies in the three focus areas of this engagement: child labour monitoring and remediation, access to education and living income for cocoa-growing farmers. Since 2019, Sustainalytics conducted more than 40 engagement meetings, aligned more than 30 global institutional investors to sign and support investor letters on, and an investor endorsement of, corporate living income and living wage roadmaps. In addition, they organized a roundtable named 'Accelerating farmer livelihoods' as well as webinars on living income, all with very good level of participation by companies and leading topic experts.

It is probably fair to say that the challenges the world is facing are probably larger today, than they were three years ago at the inception of this thematic engagement, not the least negative global developments with regards to poverty and child labour. On the latter, a June 2021 report from the ILO and UNICEF points to the first increase in child labour in 20 years. According to the statistics, there are 160 million children in child labour in the world, accounting for nearly 10% of the world's children. Most, 70%, of child labour happens in the agricultural sector Child labour is increasingly concentrated to Sub-Saharan Africa. A large portion, but not all, is explained by the economic downturn following the COVID-19 pandemic, in particular income losses among vulnerable families. School closures is another related impact

from the pandemic. According to the ILO, there is also a knock-on effect on child labour when poverty levels increase. Based on historical data, a 1% increase in poverty equals to at least a 0.7% increase in child labour. According to estimates by the World Bank, poverty levels are increasing globally. It estimates that an additional 75 million to 95 million people could be living in extreme poverty in 2022 compared to pre-COVID-19 projections. With the correlation between poverty and child labour, it means increases in poverty globally will lead to an estimated increase in child labour globally of about 52 million to 67 million children.

A child labour in cocoa specific survey was also released during the course of this thematic engagement, commissioned by the US Department of Labour and conducted by the University of Chicago and released in October 2020. It concludes that the number of children working in cocoa farming in Ivory Coast and Ghana has not decreased but remained stable amid an increase in cocoa production. On a positive note, the report states that school attendance among children in agricultural households increased. A separate study, commissioned by the World Cocoa Foundation (WCF), suggested that hazardous child labour has been reduced by one-third in communities where company programs are in place.

At the time of the baseline assessment in November 2019, the overall KPI fulfilment rate for all companies combined was at 43%. By the time of the final report in August 2022, this had improved to 70%. As shown in the chart below, all three KPIs/focus areas: child labour monitoring and remediation, access to education and living income, improved.



Average score per KPI for all companies in this engagement. Development from baseline 2019 to August 2022.

In terms of child labour monitoring and remediation, companies have improved both on effectiveness, i.e., having a robust methodology in implementing CLMRS, and in terms of scale of CLMRS roll-out. With regards to access to education, a major announcement was made in spring 2020, with several cocoa companies committing to support two new programmes by the

Jacobs Foundation in Ivory Coast. The main programme aims to reach five million children in cocoa-growing areas and beyond, focusing on access to quality primary education.
Lastly, on living income, living income benchmarks are in place, conducted by ISEAL, GIZ and the Sustainable Food Lab, and have been updated during the course of the engagement. Some companies have living income commitments in place and all companies engaged with communicated several activities in relation to the enablement of living income for cocoa-growing farmers. Several companies are explicitly measuring farmer income as a part of monitoring their respective farmer programmes in West Africa and some companies have reported initial income related data of farmers in communities reached by their farmer programmes.
As part of its recently initiated Human Rights Accelerator Thematic Engagement, Sustainalytics will continue engaging the cocoa sector on the issues of child labour and living income.

This thematic engagement seeks to directly contribute to the Sustainable Development Goals. SDG 1 on No Poverty, SDG 2 on Zero Hunger, SDG 4 on Quality Education, SDG 8 on Decent Work and Economic Growth, SDG 12 on Responsible Consumption and Production and SDG 17 Partnerships for the Goals. It is indirectly connected to several others. Further detail is available at: https://connect.sustainalytics.com/thematic-engagement-child-labor-in-cocoa